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Lionberger, Isaac Henry

Tight money

St. Louis

1920

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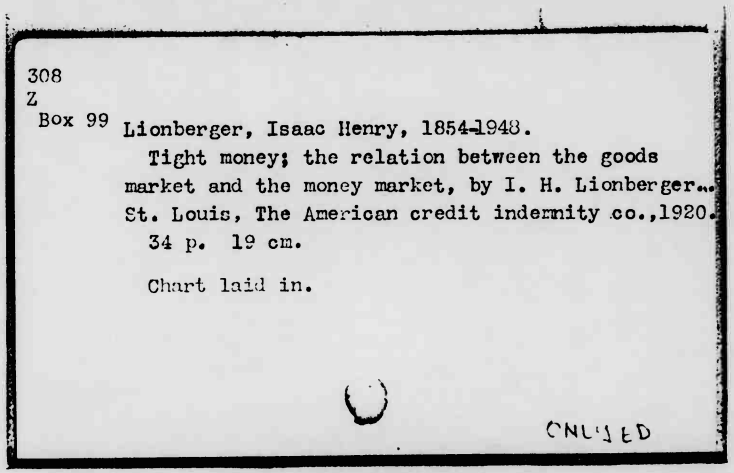
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Lionberger, Isaac Henry, 1854-1948.
Tight money; the relation between the goods market and the money market, by I. H. Lionberger..
St. Louis, The American credit indemnity co.,1920.
34 p. 19 cm.
Chart laid in.
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TECHNICAL MICROFORM DATA

FILM SIZE: 35mm REDUCTION RATIO: 9:1 IMAGE PLACEMENT: IA (IIA) IB IIB

DATE FILMED: 3-7-97 INITIALS: RB

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The Relation Between the Goods Market and the Money Market

By
I. H. LIONBERGER
CHAIRMAN OF
THE AMERICAN CREDIT-INDEMNITY CO.

Published by
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St. Louis, Mo.
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Copies to be had of the Company on Application

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TIGHT MONEY

The Relation Between the Goods Market and the Money Market.

The notion that either money or credit can be created by law is one of the pestilent and persistent heresies against which no community can ever become immune. Subtle, plausible and insinuating, it promises good to everybody, is easily availed of and seems instantly beneficial. A nation lacking goods and needing them in an emergency, prints notes and buys with them. Nothing is simpler. The notes cost nothing. They are not money but they "circulate" as such. The community welcomes them because they create a demand for goods, stimulate trade, put up prices, increase profits and induce an intoxicating prosperity.

Then comes the after-sickness and the day of reckoning. The cost of living mounts higher and higher, and men begin to murmur and protest that prices are exorbitant. While "money" is abundant, it will buy less from day to day. Goods are scarce, sellers are insolent, something is wrong. Discontent becomes clamorous; violence follows. Strikes lead to lockouts, and production is curtailed. What is the matter?

Now arise a host of quacks each with his panacea. One suggests prosecutions for profiteering, another price control, another a living wage, another a stabilized dollar, and another more money. All are tried; none are curative. Of the medicines prescribed, the last is worst. It serves as a brief stimulant, and then brings about a violent reaction. Trade again revives, prices rise, wages advance and the invalid lifts his head with fevered animation. But prices cannot continue to advance. There is a limit to the resources of the average individual. He cannot increase his income. His credit is exhaustible; his bills accumulate; his needs are pressing. Day by day he finds it more difficult to live. To make both ends meet, he must surrender first this and then that comfort to which he had become accustomed. When a considerable part of the community shall have been reduced to these straits, the demand for goods falls off: not the need for them, but that commercial demand which can afford to pay for commodities the price asked. Then is heard a new complaint: goods cannot be disposed of at a profit, trade is dull, something must be done, and so the mischief proceeds, growing fat by what it feeds on.

What the people need is goods; what they get is notes, notes incessantly, and the effect of the

issue of the notes is to rob them of what they need. If at such a crisis some hard-headed cynic shall venture to say, your notes are your enemies, he will provoke the hostility of all usurers, but someone will consider and then inquire, what are these notes? They are not money but promises to pay money. Can I get money for them? As soon as many men ask this question, the notes are doomed; for who can pay? Repudiation follows and a mad delirium, during which the notes vanish like thieves whom vigilantes pursue.

Does the reader object that my sketch is fanciful? I am describing realities, not dreams. The Colonies had the disease, and the Confederated Colonies and the Confederate States. Austria, Germany and Russia are suffering from it today. In Russia a pair of boots costs 8000 rubles. Austrians are paying a hundred crowns for a night's lodging. Paper money there, as with us formerly, is abundant, but all else is scarce. Trade is prostrate, industry is paralyzed, and people are starving.

The notes put out were not money but promises to pay money, and the maker will not pay: it can not. No government is a gold mine. Its taxes are paid in notes. There is no gold; all of it has disappeared. If any shall attempt to fund its

currency by offering in exchange long time bonds, ruin will follow, for taxes must be levied to pay interest and the people are poor and their burdens are already heavy and gold is lacking. Moreover, if the notes be so disposed of, how can men do business together? Must they barter goods for goods and revert to barbarism? In what must debts be paid? This man borrowed a thousand crowns to buy a coat: can he tender a coat in satisfaction of his debt, or must he tender bonds worth 10 coats? Who shall decide? Because none know what is just, and bonds involve heavy burdens, the weaker nations must drift into insolvency. The delirium will then be over, and slowly, laboriously and painfully men must win back to sound money and comfort by self denial. Such is the lesson of history, but none seem to have learned it.

The English adopted restriction during the Napoleonic wars and would not suffer their great bank to redeem its notes. It then prohibited the export of gold. France put out assignats during the revolution. None were redeemed. Both England and France resorted to the same expedient during the recent war. You cannot today export sovereigns from England, nor can you get gold for its treasury certificates. A dollar in gold is worth

ten paper francs; it used to be worth five. A sovereign is worth $3.50; it used to be worth $4.86.

We also have put out notes,—more notes by far than were ever uttered by the Continental Congress. We shall pay, of course we shall pay; but the disease is upon us. It is not quite the old disease, but it differs only as the grippe differs from the influenza. Our notes are not immediate obligations of the government. They are guaranteed by the government to be sure, but the government is not primarily liable. All of them are "secured" by commercial paper, by goods in process of production or on the way to market, as all wildcat notes were secured. Of course they will be paid, for good men are liable for them. The Reserve Banks can call them in. Yes, but how can these good men pay? They own nothing but goods. These they must sell if payment be demanded, and selling is hard when all are forced to sell. Inflation advances prices; deflation puts them down. Must a man sell what cost him 1000 for 800, in order to pay his debt? Who will be odious enough to insist on such a sacrifice? Not the Reserve Banks: they were organized to help business and promised abundant money at low and uniform rates of interest everywhere, at all

times and under all circumstances. They loaned notes in order that men might buy. Let them wait for better markets. And they wait, easing the situation by putting out more notes.

Yet they cannot wait forever. If, sitting tight, the Reserve Banks put out no more notes, what will follow? Will not prices gradually become adjusted to the fixed circulating medium? They will not rise, perhaps, but in the course of time, will they not become "stabilized" at a high level, a higher level in fact than their gold value? Everybody knows that inflation puts up prices; if it does, then continued inflation will keep them up.

If prices are and remain high in America, what should be the result? Foreigners will seek our markets in order to get much for their goods. If they do, how must they be paid? They will not accept notes. People who buy from them must therefore present notes for redemption in order to pay in gold. If they do, what will be the policy of the Reserve Banks? They cannot refuse gold, for if they do their notes will begin instantly to depreciate. If they pay out gold and supply the vacuum with other notes, will not the endless chain of Cleveland's time again operate to withdraw from the country all of its gold? If

they pay gold and retire the notes redeemed, the currency must be deflated. What under such circumstances will be the predicament of the trader? He is confronted at once by foreign competition and a shrinking currency; and both tend to depress prices. Must he now sell for 800 what cost him 1000? How can the Reserve Banks help him? They are confronted by repudiation or a necessary contraction: which horn of this dilemma will they choose?

So in time men will be forced to understand that notes are debts and not money, and that some day, somehow, by somebody, they must be paid. Easily put out, they are hard to pay. We cannot create money by a printing press, not even with the aid of the Reserve Banks. We can create obligations, but obligations are debts, whose horrid significance has been embalmed in the phrases "not worth a continental", "wildcat notes", "shin plasters", "fiat money".

Such issues deceived the Puritan and the Cavalier, the cunning trader of New England and the rough frontiersman of Illinois, the statesmen who framed the Articles of Confederation and the patriots who conducted the Civil War. That we also are deceived by them is proof positive that

the experiences of one generation do not become the intuitions of that which follows. Men still lack the intelligence to understand that paper money is not money.

Money is a reality; so is credit. The one cannot be created by the printing press, nor can the other be created by book entries. If the banks could create credit, it would be worth nothing, for what costs nothing no man will pay for. Cheap money and cheap credit are phantoms of a perverted imagination. Let us consider what credit is, and what it depends on.

If I lend to another, I lend what I have and he lacks. I may lend either money or credit. Money is real wealth, it has intrinsic and therefore exchange value, one may buy with it and pay with it. Credit is an intangible thing; nevertheless it is a substantial, definite thing. Its implications are distinct. It always conveys a representation or warranty, and a promise. If I lend my indorsement to another, I convey to the person with whom he deals the assurance that I have the means to pay and will pay in the event that the maker of the note does not. My indorsement is worth something because it contains these implications; these lacking, no one will trust it. Credit

always rests upon the known or presumed means of the promisor, and is restricted to such means. One reputed to be worth $1000 can add little by indorsement to a note for $100,000. If, having but $1000, he indorses a note for $100,000, he deceives and intends to deceive all to whom his indorsement may be offered. If I inform the public I will be responsible for all debts another may incur within a limit of $100,000, I represent to the public that I am worth $100,000, and his credit, so acquired, rests upon the assurance conveyed by that representation. Credit and means of performance are inseparable in the minds of all persons to whom the credit may be offered, and save for the purpose of deceiving, no one should by his indorsement or otherwise pretend to have more goods than he has.

The credit of a bank does not differ from that of an individual: it rests always on the actual or presumed resources of the bank, and is limited to those resources. If it has $100,000, it may lend that sum, but not $200,000. Where it lends its credit, it assigns to a borrower the right to withdraw so much money in the event he shall wish to do so; and by its lending, it represents that it has what it lends.

As you cannot increase the stock of grain on hand by putting out spurious warehouse receipts, so you cannot increase the actual resources of a bank by credit entries. Such entries mean a definite thing, and although they may not be representatives of a special property, as is a warehouse receipt, yet they do convey the assurance that the bank has the means to pay the amount specified, on demand. If a bank having $100,000 lends $200,000, it may get by with it, to use the slang of the street, but its risk is great, and trouble is likely to follow. A grain elevator might safely issue receipts in anticipation of a crop, and if all goes well redeem them, but such a practice should not be encouraged. Neither should a bank be permitted to lend phantom resources in aid of trade, however likely it may be that goods in the making or on the way to market will be used to pay the loan. I, however solvent, should not draw my check because I expect some time to be in funds. Neither should a bank do what amounts to the same thing: the practice is bad, it tends to trouble and the law prohibits it. If we ask why the law is so, it will be difficult to answer, for the law allows the reserve banks to issue paper money, and currency predicated upon a discount does not differ essentially from a pass-book credit entry

predicated upon the same sort of obligation. Of the two, the credit entry is the safer because the credit granted is usually brief and has a definite maturity, whereas banknotes do not mature in this sense but remain out indefinitely. In this respect our banking system is less sound than the Canadian. There banks may issue notes, but no bank can pay out another's. If our law were similar, our notes would approximate in character to checks payable on demand, and inflation would be impossible. Perhaps we discriminate against excessive discounts because there results from them the likelihood that the amount loaned may be immediately called for, whereas notes are not likely to be immediately presented for redemption; but whatever the reason, banks may now lend, by book entries, what they have to lend and no more.

What then has a bank to lend? Its resources (barring notes) consist of capital and surplus and individual deposits—I say individual deposits, because all others are but duplicates of these originals. Capital and surplus are as a rule invested in interest-bearing securities or other property and therefore, broadly speaking, the lending resources of the banks are derived from and limited to their individual deposits. What are these deposits?

They are not cash, for the deposits of all the banks of the country are many times greater than its total money, currency included. The explanation of this disparity is too well understood to require discussion. Deposits originate in wages earned, the proceeds of goods or property sold, interest on invested capital, rents and income from various other sources, and these are usually paid with checks and deposited as checks. But whether of money or checks, a deposit means always the same thing, namely: the right to purchase in the market goods worth the face of the deposit. It originates in goods or services, and is and remains a right to buy equivalent goods or services. If my account shows a credit of $1000, I, having somehow earned the right to goods of that value, may spend it in the purchase of things I desire, and for such purpose may either withdraw money or assign my right to money by the use of a check. A bank deposit is in fact but a convenient means of accumulating the proceeds of special goods or services, and exchanging them for other goods or services.

It is true that every discount involves a corresponding deposit entry, and that the aggregate of the stated deposits of a bank is greatly in excess of its actual deposits; nevertheless such artificial

deposits are limited by the cash reserves required to be carried and cannot greatly exceed the actual resources of a bank. Broadly speaking, the resources of all banks consist of rights to goods, however superficially they may seem to consist of rights to money.

When men are saving or making money, as we express it, or accumulating rights to goods originating as I have indicated, deposits tend to increase, and when they are spending more than their incomes, deposits tend to decline. Incomes depend upon many considerations; expenditures chiefly upon the cost of living, and as the cost of living is less where goods are abundant and cheap, and higher where they are scarce and expensive, deposits should fluctuate accordingly—and they do. If my income is $5,000 a year and it costs me $4,000 to live, I may increase my deposit by $1000; but if it costs $5,000, I can save nothing.

The lending resources of the banks fluctuate in harmony with these influences: rising when goods are cheap and depositors are accumulating, and falling as the cost of living rises.

Bearing these principles in mind, we may with propriety say that advancing prices tend to exhaust bank deposits, and falling prices to replenish them;

and in the light of these considerations it ought not to be difficult to understand why rates of interest are sometimes high and sometimes low.

The money market is like the goods market: it depends on the demand for and supply of credits. Where deposits are increasing and credits are accumulating, money is said to be easy; it hardens as soon as deposits begin to decline, and becomes tight when they shall have been exhausted. This is the explanation of stringency and high rates of interest. A credit is but a means wherewith to buy goods, derived from the depositors of the banks who have accumulated rights to goods. Where such rights are scarce, the borrower must pay more than where they are abundant. Rates of interest are therefore high when rights to goods are scarce. This is the explanation of stringency in the money market: it is never caused by trade.

John Law and his followers conceived of business and money as cart and horse, and because a cart can not be started without a horse, argued that business could not be started without money. Today, deceived by the same analogy, men insist that money is not only necessary to start business but to keep it going, and argue with equal reason, that since an active trade involves more and more

transactions at advancing prices, the money market should be fortified from time to time by more money or more credit. Such an argument is plausible and has the sanction of the highest authority. The banks have loudly boasted that by means of notes the government has been able to finance the greatest war of history, and at the same time business has been made prosperous and wages have been increased.

If they are right, why have they ceased lending? The notes cost them nothing, they have a monopoly of their issue, the rates charged are extremely profitable.

The truth is, the banks have blundered. Inflation did not finance the war, it made it more expensive: it did not help trade, for the waste of war created a demand for goods which was insatiable; it did not enrich the community, it imposed upon it an enormous burden of debt and raised the cost of living by leaps and bounds. Inflation was never necessary. An active trade at advancing prices cannot exhaust either money or credit. Money is not consumed by use; credit cannot be exhausted by profitable trade. The quantity of money in use has nothing to do with the prosperity of trade. We have had active trade with $16 per capita and

dull trade with $36. $1000 per capita has not sustained the trade of Russia. Trade is not a cart nor is money a horse.

The notion that trade exhausts credit may bewilder the inconsiderate, but it should not deceive men of affairs. The whole effect of profitable trade is to redistribute the deposits of the banks, and such redistribution cannot either add to nor subtract from the aggregate of such credits. If I borrow from a bank $1000 to buy goods for $1000, and sell them for $1200, one depositor, the seller, gets a credit for $1000; another, the buyer, has charged against his account $1200, and the difference is credited to my account; but the bank has neither more nor less than it started with. It started with $1200, and it still has that amount.

Profitable trade is sometimes followed by an exhaustion of bank resources, but is never the cause of such exhaustion, for trade is but the means whereby the consumer gratifies his wants. If a deposit declines, it is because the depositor is spending more than his income that is, consuming his deposit. An active trade at advancing prices shows that more goods are being consumed than are being accumulated, but such trade is the effect

and never the cause of such extravagance. Falling deposits and profitable trade are often coincident, but when they are it is always because the cost of living is rising and men are spending more than their incomes. Although the profits of trade can have no actual effect upon deposits, yet where trade is conducted at a loss, as it may be on a falling price market, the losses incurred must impair the resources of the banks unless the public is saving more than the traders are losing. The temporary stress in the money market which precedes a crisis or panic is caused by the pressure of trade losses in excess of such saving, and for this reason rates of interest do not precisely and immediately conform with the following principle.

Rates of interest do not fall immediately after prices begin to decline because temporarily rates are more affected by the hazardous situation of former borrowers than by the increase in the supply of goods.

Rates of interest depend in the long run upon the supply of and demand for legitimate credits, that is rights to goods. When such rights are abundant, interest rates are low, and vice versa. Interest rates are always low when trade is dull, and always higher when trade is most active; but

trade is dull because consumption is arrested and active because goods are being consumed. Extravagance exhausts, self-denial accumulates, and trade is an incident—not a cause of either consequence. The cause of high rates is as a rule scarce goods.

If we adopt this suggestion, then it follows that the cure for high rates is either increased production or less consumption of goods, and we must abandon the notion that the disparity between the supply of and demand for goods can be cured by artificial money or credits. Where wheat is scarce, you can not make it abundant by putting out spurious warehouse receipts; neither can you make goods abundant by false banking credits or notes; for goods are produced not by the printing press and arbitrary book entries, but by the fields and factories. Such spurious expedients, by affording buying power to new spenders, increase the demand for goods; they cannot affect the supply; and so the stress against which the false credit is directed is rather increased than relaxed by inflation. If I, who have spent all my income, could continue to buy with promissory checks, there might be no limit to my spending. False credits afford a like temptation to extravagance, and when

they are granted in time of scarcity very great trouble must follow.

Further inflation now is in the highest degree perilous. We have already put out more than $3,000,000,000 of new notes, and these notes, by affording a spurious buying power not only to the trader but the consumer whom he serves, have resulted in a flattering but borrowed prosperity which must some day be atoned for. Every note put out or false credit granted, is a promise which must be performed. All of them are secured by the obligations of farmers, manufacturers or traders to pay money; and in order to pay, every borrower must somehow provide and convert into money goods worth the face of his debt. The day of reckoning must come. The reserve banks are now attempting by restricting accommodation to compel liquidation, and enforced selling must in time affect the market prices of goods. It is always hard to pay debts contracted for goods on a rising market with the proceeds of goods pressed for sale on a falling market. A period of trial and reaction lies ahead of us. Extravagance is diminishing, enforced selling is under way, prices are falling and will continue to fall until in the course of time goods again become abundant and cheap. The highest prudence is now necessary. The debts of

business men are enormous: discounts were never so great. The market value of the goods by which they must be paid is steadily declining.

We have had abundant crops, and the supply of goods of all sorts is increasing. The drain upon us caused by the necessities of Europe is diminishing day by day. Imports are increasing. The extravagance of the government should cease. Taxes will become less burdensome, private extravagance is abating. As prices fall, and fall they must, it will be increasingly hard to meet obligations heretofore incurred with goods on hand. To pay debts recklessly incurred is always difficult; but they must be paid, and the sooner they are paid the better. It is better that goods costing $1000 should be sold for $900 than for $800. High rates of interest force merchants to do what they should do and yet are reluctant to do. The policy of the Reserve Banks is altogether wise. It tends to a gradual rather than a violent liquidation. High rates cannot be maintained where they are no longer useful. They are high because they are useful. When goods become more plentiful and credits accumulate, rates of interest should fall, but not before. In the meantime, we should welcome their corrective influence.

To issue notes was folly: they afforded the means to buy but did not afford the means to pay. To issue more notes when liquidation already is difficult, and because it is difficult, is to induce bankruptcy. The present demand for easy credit springs from the distresses of men who have become indebted and find it hard to extricate themselves. They wish to borrow more because they cannot pay what they owe, and think time will work for them. They are mistaken.

These are the considerations which justify the present policy of the reserve banks. They have a hard task to perform. It justly rests upon their shoulders. They and the banks which compose them have negotiated the post-obits which afflict us, and have made enormous profits by doing so. Their task will be hateful. They must collect what they induced the public to borrow. Their debtors will not incline to forgive them, much less encourage them, for what formerly they promised will be remembered and none will approve a policy which seems to involve loss to themselves.

Nevertheless the Reserve Banks are right. High rates of interest must be maintained for a time, although goods are increasing and prices are falling. Merchants and manufacturers who are in debt

must be compelled to pay before they become insolvent. Cheap money might induce them to wait.

The day for decision has come: whether to speculate with expensive goods on a falling market, or liquidate as soon as possible, gradually, constantly, when we can and as we can; this is the problem of today. There is no other alternative. Curtailed production will not answer, for debts must be paid with goods, and on a falling market it is easier to pay old debts with cheap new goods than with expensive stocks on hand. High rates of interest are constant and incessant reminders of the task which lies ahead of us. None should complain. Every trading debtor is also a creditor. What induces him to be provident will have a like influence on his customers, for the merchant who must pay must collect; and so the community will be gradually brought to a sounder and safer prosperity than that feverish, unjust enrichment which has characterized the boom of the war.

The day of the profiteer and scamp workman is passing. Competition will again become keen. To sell cheaply, we must produce cheaply. Those who can not or will not, must find other employment. A period of increasing insolvency is ahead

of us. Work will be harder to find. None will hold a job unless he earns his wages. Raw material will decline. Goods should cost less from day to day.

It rests with the Reserve Banks to decide whether we shall accomplish such readjustment by a gradual and easy declivity, or abrupt precipice. If they hesitate, and turn back, and begin again to inflate the currency, calamity is inevitable. It is possible to avoid serious trouble. There is still work for everybody. The waste of the war has not been repaired. The railroads must be reconstructed and re-equipped. Homes must be provided. Capital must be accumulated. To facilitate these reparations is the problem of the future, and to ease the derangements which must attend them. The future is not dark. Men need cheap goods. Falling wages will be compensated by cheaper goods. The tension between employer and employee will lessen. The folly of strikes will become evident. Rents will decline, and the cost of living be gradually but constantly reduced.

High rates of interest not only induce liquidation while there is yet time, but afford a motive to cheap production; check waste, extravagance and inefficiency; and avoid the dangers which threaten

us by pointing out the road to safety. If, forgetting their responsibility, the banks shall relax their grip upon the reins, we shall have a run-away market and that sad delirium which invariably results in panic.

The future course of events will be of absorbing interest not only to the observer, but to every man of affairs. The readjustment following the war will be slow, persistent and inevitable. The currencies of all the nations have been inflated. Many of them will be repudiated. The gold of the world must be set free in order that it may perform its necessary function. It alone can measure the values and effect the exchange of goods on fair terms. Today values are falsely estimated in spurious and inconstant and widely different standards. Paper money must be got rid of and imprudent credits must be discharged. Whether these objects shall be achieved by repudiation and bankruptcy, or by industry and self-denial, is the responsibility of each community. Our banks are now trying to compel the wise course—not by violence and inconsiderate haste, but by constant pressure. No one should complain of high rates: they will be useful so long as they can be maintained. When they shall have performed their

service, they will fall, for no one can sell credit for more than it is worth in the market, and when credits become abundant money should be cheap, but not before.

It is to be regretted that the money market is hard to understand. Bankers and merchants use a jargon of their own which briefly expresses very complicated considerations, but this jargon, like that of the lawyer, is apt at times to fall far short of what it aims at. "Tight money" for example, is a deceptive phrase which expresses an unintended fallacy. Money can not get tight. The supply should be constant, and the demand is always without limit. What the phrase implicates is not true. Money is frequently tightest when it is most abundant. When we had $35 per capita, it was worth 4%; today when we have $56, it is selling for 7 and 8%.

Such phrases are frequently deceiving, even to the man who uses them. Interest rates have never had anything to do with the quantity of money in use. They are usually highest during a period of inflation. They depend upon the supply of capital and the demand for it; and everybody knows that by capital no one means money. Money is the medium whereby capital is measured and procured.

We put capital into a railroad; money buys the rails and rolling stock, and where these are hard to get we say that money is hard to get, but we mean that capital is scarce. When goods are cheap, money is always cheap. High rates of interest mean no more than that the goods market is exhausted, or that men can not pay their debts with goods on hand at current prices.

We are apt to forget that banks are but media for the exchange of goods for goods. Their intervention cannot affect either the supply or demand. It is true that what they lend is used to buy goods —but lending cannot affect the quantity of purchasable goods. The goods are already scarce or abundant, and the borrower must pay the market price. On a rising market goods are worth more for sale than on a falling market, and rates of interest are higher not because it costs more to buy but because goods are scarcer.

"Tight money" should be used with respect to a period of constriction, that is, to a period when pressure is requisite to induce men to sell goods before a decline in prices shall compel their sale at a loss. Money should never be tight during a period of genuine prosperity. Rates of interest harden as prices approach a peak and danger threatens.

The notion that rising prices result in the need for more money wherewith to buy goods is just only in the sense that men reckon in larger sums and credits sound larger. The reality behind the reckoning is the gradual depletion of stocks of goods; for rising prices (apart from inflation) always indicate that more goods are being consumed than are being produced. The demand for money is actually a demand for more goods. Prices and interest rates rise or fall together, for both are shadows of the same reality, namely, scarcity or abundance in the goods market.

If this be true, then it follows that as prices cannot be fixed in disregard of the law of supply and demand, neither can interest rates be controlled by any expedient in disregard of the same law. Price fixing, however ingenious, always results in an effect contrary to that intended, for if prices be forced too low men will not sell and prices advance; if too high, men will not buy and prices decline. So it is in the money market. You can neither raise nor depress interest rates arbitrarily, and every effort to do so must result in disappointment. For example: if you ask too much for money, you check borrowing and induce liquidation; if too little, you induce borrowing and check liquidation. In the former case, your expedient must result in

falling rates of interest, and in the latter, in rising rates—just the contrary of what you intended.

Inflation as a means of lowering interest rates has always been followed by a contrary result. It puts up the prices of goods by increasing the demand and reducing the supply, and puts up interest rates because, as goods become more scarce and prices advance, more currency is required in order to buy; or, to put the same thing in another form: inflation tends to greater stringency in the goods market and therefore to increasing stringency and higher rates in the money market. You cannot make goods cheap by inducing extravagance, nor can you make money cheap by inducing borrowing.

Deflation on the other hand is always followed by forced selling, falling prices, more efficient production, greater abundance, gradual liquidation, less borrowing and falling interest rates.

Where money rates are permitted to be responsive to the goods market, high rates are inevitable during a period of extravagance and waste, low rates during a period of saving and accumulation. No rate can be maintained too long. As soon as goods become abundant and credits accumulate, the rate must fall.

Of the evils now confronting us, none is comparable with inflation. Solemn congresses assemble here and elsewhere to discuss all things but the disease that afflicts us. Germany and Russia, and Austria and Italy, and France and England and ourselves are afflicted by the same disease. Industry is shackled by paper money. The need of the hour everywhere is deflation, for deflation will emancipate trade and set it free to conduct its operations with the money and subject to the laws which are indispensable to the general welfare. To make real money cheap is impossible: it is a commodity like wheat, having an intrinsic value worth in the money market what it will sell for. To compel men to trade with paper money having no value, worth nothing and promising what it will not perform, is to embarrass trade and check production, and induce extravagance at a time when every sort of encouragement should be given to economy. The world needs goods and a sound medium for their exchange. It is afflicted by profuse issues of false currency which discourage production and induce waste.

We have been less afflicted than others, but we too have been victims of the general delirium. Like the heir expectant who resorts to post-obits

to raise the wind, we have gladly embraced a brief period of borrowed joy and must now reflect upon the consequences.

I cannot think a period of prolonged depression confronts us. There is still work to do. The needs of the community have not yet been satisfied. Gradually we shall achieve by work a genuine prosperity altogether preferable to that bewildering and false prosperity which has been characterized by so much unjust enrichment and so much unmerited poverty. If wages shall be less, they will purchase more; if profits less, they also will purchase more; and the burden of debts will become gradually less irksome—always provided we do not turn back and, under the impulse of a misguiding frenzy, repeat the indiscretions of the past.

There are men who think the fall in prices will be temporary. They are mistaken. A gradual but constant fall is inevitable. Prices began to fall after the Civil War and continued to fall for thirty years. Every war has been followed by a similar reaction.

Money will become easier because goods will become more plentiful. The waste of war has ceased; soldiers have become producers; foreigners will soon be self-supporting; the cost of living will

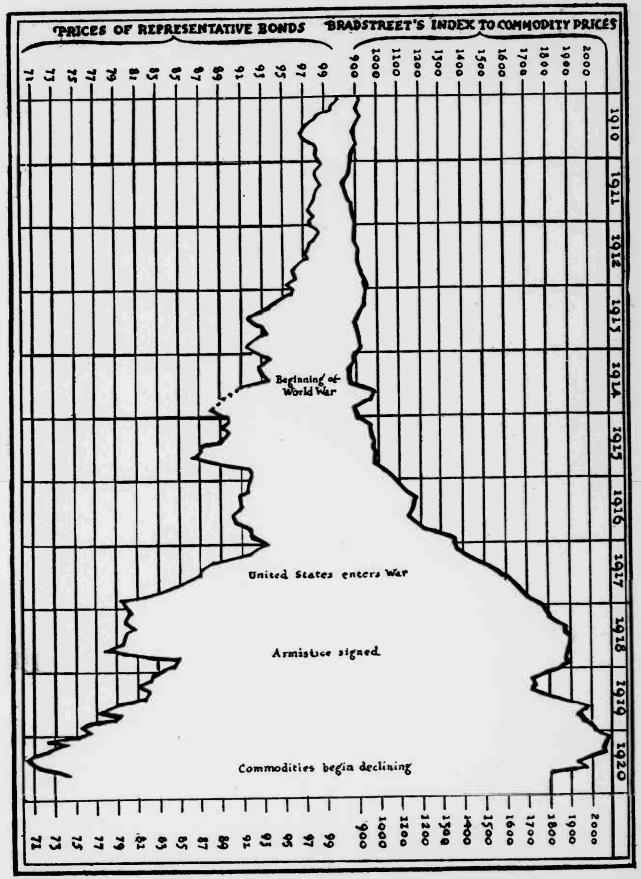
decline; money will be cheaper, as soon as trade losses shall have been charged off.

The need of the hour is gradual, constant, inexorable deflation. The policy of the Reserve Bank in the emergency which confronts us is unpardonable. Yielding to the solicitations of the community, it has increased the currency nearly six hundred millions of dollars during the past year, and there are now outstanding more than $3,300,000,000 of note which must be paid somehow. These notes tempted to extravagance and speculation, and now serve to sustain a tottering credit situation which becomes more threatening day by day. Their issue has not served to ease the money market, nor to lower rates of interest. Their currency adds to the burdens of a period of reaction a heavy load of improvident indebtedness which must be satisfied by the sale of commodities upon a falling market. Resources intended to be kept for emergencies have been squandered. Already the wrongs done by the Reserve Banks are coming home to roost. Their path will be beset by thorns. They have let foolish men have their way, and have been unequal to the high responsibility imposed upon them. None praise them; many complain of them. The Comptroller of the Currency publicly charges that they have not curbed

the rapacity of the banks. What they attempt even of good is fiercely denounced. We have a right to complain of them. They have attempted to provide sound commercial credits with false money, and we must suffer the consequences of their folly.

Postscipt:

After the completion of this essay, the following table compiled by A. B. Leach & Co. of Chicago, came into the hands of the writer. It proves in a graphic way the principle which the essay attempts to establish, namely, that as commodity prices rise interest rates advance, and vice versa.


PRICES OF REPRESENTATIVE BONDS
BRADSTREET'S INDEX TO COMMODITY PRICES
71 73 75 77 79 81 83 85 87 89 91 93 95 97 99
900 1000 1100 1200 1300 1400 1500 1600 1700 1800 1900 2000
1910 1911 1912 1913 1914 1915 1916 1917 1918 1919 1920
Beginning of World War
United States enters War
Armistice signed
Commodities begin declining

22.80

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TITLE